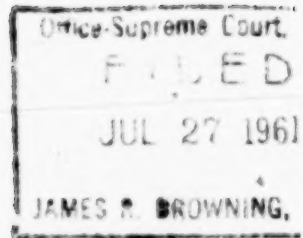


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IN THE
Supreme Court of the United States

October Term, 1961.

No. 190.

UNITED STATES,

Petitioner,

v.

THOMAS CRAWLEY DAVIS and GRACE ETHEL DAVIS,
Respondents.

**BRIEF IN OPPOSITION TO PETITION FOR A WRIT
OF CERTIORARI.**

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The government has advanced two reasons for review of the Court of Claims decision that the taxpayer realized no taxable gain on account of his transfer of stock to his wife.

First, the government alleges that the Court of Claims decision is in conflict with the decisions of the Courts of Appeal for the Second and Third Circuits. The taxpayers will demonstrate in this brief that *under the facts in this case* there is no real conflict between the decision of the Court of Claims in this case and the decisions of any other courts.

Secondly, the government asserts that the decision of the Court of Claims involves an important issue of law which, if decided in the taxpayers' favor, will result in the elimination of all income tax on the appreciation in value of property transferred in connection with marital settlements incident to separations or divorces. Taxpayers will demonstrate that the decision of the Court of Claims does not cause the result suggested in the petition for certiorari.

STATEMENT OF THE CASE.

The taxpayers accept the government's statement of the case with one exception.

The government's statement of the case fails to adequately point up a fact which has an all-important bearing on the question whether this Court should review the decision of the Court of Claims. In the separation and property settlement agreement between Thomas Crawley Davis and his wife, Alice M. Davis, the parties and their counsel were careful to specify as separate items the amounts to be paid by Mr. Davis in discharge of his marital obligation to maintain and support his wife and their minor child. Paragraphs 5, 6, and 8 of the November 4, 1954 agreement between T. Crawley Davis and Alice M. Davis (R. 9, 10, Petition to Ct. Cls., Exh. A, par. 6). On the other hand, as a completely separate item, in paragraph 3 of the November 4, 1954 agreement the parties provided for "division in settlement of their property" (R. 7-9, Petition to Ct. Cls., Exh. A, par. 6). It was pursuant to the last-mentioned separate provision of the agreement that there occurred the transfer of stock which raised the issue with respect to which the government now seeks review by this Court.

ARGUMENT.

The government contends that the decision of the Court of Claims holding that the husband taxpayer realized no taxable gain on account of his transfer of stock to his wife should be reviewed by this Court on the following grounds:

1. Because the Court of Claims decision is alleged to be in conflict with the decisions of the Court of Appeals for the Second and Third Circuits in *Commissioner v. Mesta*, 123 F. (2d) 986 (3rd Cir. 1941) *cert. den.* 316 U. S. 695 (1942), and *Commissioner v. Halliwell*, 131 F. (2d) 642 (2nd Cir. 1942) *cert. den.* 319 U. S. 741 (1943).

2. Because the legal issue involved is important to the revenue and a failure to reverse the Court of Claims decision on this issue will result in a loss of revenue through elimination of all income tax on the appreciation in value of property transferred in connection with marital settlements incident to separations and divorces.

Both of these grounds are demonstrably untenable and the petition for a writ of certiorari should accordingly be denied.

There Is No Real Conflict Between the Decision of the Court of Claims and the Mesta and Halliwell Decisions.

In the *Mesta* and *Halliwell* cases the Courts of Appeals for the Third and Second Circuits decided that a husband realized taxable gain when he transferred appreciated property to his wife in discharge of his legal obligation to maintain and support her. In reaching this result, both Courts of Appeal reversed contrary decisions of the Board of Tax Appeals.¹ The lack of real conflict between the Court of Claims decision in this case and the decisions

1. *L. W. Mesta*, 42 B. T. A. 933 (1940) and *Walter S. Halliwell*, 44 B. T. A. 740 (1941).

in the *Mesta* and *Halliwell* cases is best pointed up by a significant omission of language in the government's petition. At pages 4 and 5 of the petition it is stated:

“* * * On their facts, both cases [*Mesta* and *Halliwell*] are indistinguishable from the case at bar. In each, *precisely as in this case*, a husband transferred appreciated stock to his wife pursuant to a property settlement. In each, the wife, in return, released all claims to maintenance and support and all rights to share in the husband's estate. * * *” (Emphasis supplied.)

In the first of the above-quoted sentences the government equated its description of the *Mesta* and *Halliwell* situations with that present in this case by noting that in the *Mesta* and *Halliwell* cases, “*precisely as in this case*” the husband transferred appreciated stock “pursuant to a property settlement.” However, it is significant that in the second of the above-quoted sentences the government did not (because it could not) similarly equate the situation in the instant case with those in the *Mesta* and *Halliwell* cases wherein the wife released her claims for maintenance and support in return for the transfer of appreciated securities. Therein lies the significant difference between this case and the *Mesta* and *Halliwell* cases. The record in this case is devoid of any basis for the assertion that Mr. Davis transferred securities to his wife in discharge of an obligation of support and maintenance. If Mr. Davis had transferred appreciated securities to his wife in discharge of his obligation to support and maintain her, the taxpayers would agree that the Court of Claims decision on this point creates a conflict with the *Mesta* and *Halliwell* decisions. The contrary being the fact, there is no conflict between the Court of Claims decision in this case and the *Mesta* and *Halliwell* decision.

The mentioned distinction between the instant case and the *Mesta* and *Halliwell* cases has been recognized in

decided cases. It is the very distinction which the government itself has successfully urged.

In *Ida Lucille Swanson v. Earl R. Wiseman*, 61-1 U. S. T. C., par. 9264 (D. C., W. D. Okla., February 23, 1961) (not otherwise reported), the government successfully argued for the proposition that where a wife had received appreciated stock from her husband as part of a property division incident to a divorce (as opposed to a transfer in discharge of her right to alimony, support, or maintenance) the wife took as her income tax basis for the stock the same basis which it had had in the hands of her former husband. There the taxpayer argued that the *Mesta* and *Halliwell* decisions required that she receive a stepped-up basis. However, the government contended that these decisions were not in point because the wife in the *Swanson* case received the stock in question as part of a division of property and not in discharge of a support and maintenance obligation as in the *Mesta* and *Halliwell* cases. See pages 5-8 of the government's brief in the *Swanson* case.

The instant case is in the same class with the *Swanson* case rather than with the *Mesta* and *Halliwell* cases. In the *Swanson* case, the government saw the distinction and used it to successfully assert that the wife did not get a stepped-up basis. There is no acceptable reason why the government should here and now change its position and contend that for purposes of taxing a husband there is no distinction between a transfer ~~and~~ⁱⁿ discharge of a support obligation and a transfer in division of property.

Analogous distinctions exist in other areas of the income tax law. Where a corporation declares a dividend of a fixed dollar amount and satisfies that obligation by distributing appreciated property to its shareholders, the corporation thereby realizes a taxable gain. See *Bacon-McMillan Veneer Company*, 20 B. T. A. 556 (1930); *Callanan Road Improvement Company*, 12 B. T. A. 1109 (1928), Acq. VII-2 C. B. 7 and A. R. R. 435, 4 C. B. 27 (1921). In contrast, where a corporation declares a dividend in

terms of specific property, this Court has held that the distribution does not result in the corporation having a realized taxable gain. *General Utilities and Operating Company v. Helvering*, 296 U. S., 200 (1935).

The Commissioner of Internal Revenue has recognized an analogous distinction by his rulings to the effect that where a decedent's estate distributes property to a residuary beneficiary it realizes no taxable gain even though the property distributed has a value in excess of its tax basis on the date of distribution; whereas, a decedent's estate has taxable gain when it distributes appreciated property in discharge of a fixed pecuniary legacy. Rev. Rul. 55-117, 1955-1 C. B. 233 and Rev. Rul. 56-270, 1956-1 C. B. 325.

The Decision of the Court of Claims Will Not Result in an Escape From Income Taxation of the Appreciation in Value of the Transferred Property.

At pages 6 and 7 of the petition the government cites *Farid-Es-Sultaneh v. Commissioner*, 160 F. (2d) 812 (2nd Cir., 1947), and *Commissioner v. Patino*, 186 F. (2d) 962 (4th Cir., 1950), for the proposition that the wife of the taxpayer in the instant case will take as her income tax basis for the property in question the fair market value of the property as of the date of her acquisition of it. The petition then goes on to state:

“* * * If this is so, the view adopted by the Court of Claims would lead to the result that the taxpayer-husband avoids taxation on the appreciation which took place during his holding period while his taxpayer wife none-the-less obtains a ‘stepped up’ basis. Taxation of the gain is thus not merely deferred; it is eliminated.”

The *Farid-Es-Sultaneh* and the *Patino* cases do not support the proposition that the transferee wife of the instant taxpayer will secure a basis equal to the fair market value of the property as of the date of its transfer to her.

The two cited cases involve factual situations vastly different from that in the instant case. In the *Farid-Es-Sultanch* case the property in question was transferred to the taxpayer in advance of her marriage in consideration *inter alia* of her agreement to marry the transferor. The Court of Appeals for the Second Circuit decided that the agreement to marry was a valuable consideration which took the transfer out of the classification of a gift for basis purposes. In the *Patino* case the property in question was transferred to an estranged wife in discharge of a prior fixed dollar commitment of the husband for the support and maintenance of the transferee.

In contending that even though the husband realizes no taxable gain on the transfer of property—the wife secures a stepped-up basis, the government is ignoring its own victories in this very area. The most recent striking example of the government's ability to avoid the result suggested is found in the companion cases of *Marshman v. Commissioner*, 279 F. (2d) 27 (6th Cir., 1960) *cert. den.* 364 U. S. 918 (December 12, 1960), and *Estate of Gordon Stouffer v. Commissioner*, 279 F. (2d) 27 (6th Cir., 1960) *cert. den.* 364 U. S. 918 (December 12, 1960). The *Marshman* case involved the question of the tax basis of property transferred to a wife incident to a marital settlement. The case of *Estate of Gordon Stouffer* involved the issue of whether the transferor-husband realized taxable gain on account of the same transaction. The *Marshman* and *Stouffer* cases were tried in the Tax Court and considered in the Court of Appeals as companion cases. The Tax Court held that the husband realized taxable gain and, consistent with that result, held that the wife secured a stepped-up basis equal to the value of the property on the date of the transfer.² The Court of Appeals for the Sixth Circuit held that the husband realized no taxable gain on account of the transfer and, as a compliment to that result, also held that the wife

2. *Estate of Stouffer*, 30 T. C. 1244 (1958) and *Homer and Ina Marshman*, 31 T. C. 269 (1958).

did not secure a stepped-up basis. The wife filed a petition for a writ of certiorari (October Term, 1960, No. 366). The government filed a memorandum indicating that it did not seriously oppose the grant of the writ. At the same time the government filed a petition for a writ of certiorari in the husband's case (October Term, 1960, No. 512). At page 5 of its petition, the government stated:

“As is evident, the case involving the decedent husband (Gordon) and the case involving the former wife (Ina Mae) are reciprocally related. If Gordon had a taxable gain (the holding of the Tax Court), Ina Mae's basis in the stock was, *pro tanto*, increased. If Gordon did not have a taxable gain (the holding of the Court of Appeals), Ina Mae's basis was substantially lessened and her tax liabilities, upon subsequent sale of Stouffer stock, materially increased. As already observed, the tax liabilities of both were litigated below and the former wife has now petitioned for a writ of certiorari. If the petition in No. 366 should be granted and the former wife should ultimately prevail, it will be established, by the same token, that the Government properly asserted a deficiency against Gordon.

* * *

Thus, in the *Marshman* and *Stouffer* cases the government recognized that if the husband realizes no taxable gain on a transfer, it follows that the wife takes as her basis for the transferred property the husband's income tax basis. Accordingly, there is no reasonable basis for the fear that a holding for the husband will result in taxation of the gain being “eliminated.”

The result reached in the *Marshman*, *Stouffer*, and *Swanson* cases and in the instant case, *i.e.*, not taxing the husband on a theoretical gain at the time of the transfer of property, coupled with the complimentary rule of imposing a tax on the gain if any realized at the time the wife later sells the property results in no ultimate loss of revenue and

is entirely consonant with reasonable and workable rules of income taxation.

If in situations of this kind a gain is to be recognized either at a time when the husband transfers property to his wife or when the wife later sells the property, it seems far preferable to impose the tax in the second event rather than at the time of the transfer from the husband. At the time the husband transfers the property he is depleting his estate and is realizing no cash which will furnish a fund from which an income tax can be paid. On the other hand, if the tax is imposed at the time the wife sells the property, the tax will be imposed at a time when the taxpayer has realized a cash gain which will furnish the funds for payment of the tax. This seems to be the better result.

CONCLUSION.

There is no real conflict between the decision in this case and the decision in the *Mesta* and *Halliwell* cases. The result reached in this case is fair to the taxpayers and the government. The petition should accordingly be denied.

Respectfully submitted,

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